VZCZCXRO2576
RR RUEHLMC
DE RUEHAR #3025/01 3561241
ZNR UUUUU ZZH
R 221241Z DEC 06
FM AMEMBASSY ACCRA
TO RUEHC/SECSTATE WASHDC 3248
RUEATRS/DEPT OF TREASURY WASHDC
RUEHLMC/MILLENNIUM CHALLENGE CORP

UNCLAS SECTION 01 OF 04 ACCRA 003025

SIPDIS

SIPDIS
SENSITIVE

Treasury for A. Severins; Dan Peters

E.O. 12958: N/A
TAGS: ECON EFIN GH
SUBJECT: Ghana: 2007 Budget Highlights

¶1. (U) Summary. The Government of Ghana (GoG) released its 2007 budget on November 16, 2006. The 2007 Budget outlines a target growth rate of at least 6.5 percent, single digit inflation, accumulation of internatioal reserves of at least 3 months import cover, ad an overall budget deficit of 3.2 percent. Themacroeconomic policies, strategies, and targets for2007 are in line with the framework outined in the Growth and Poverty Reduction Strategy II (GPRS II). Headline initiatives include the creation of a Fair Wages Commission to facilitate public sector reform, planned investment of USD 470 million in energy generating capacity coupled with a campaign to promote energy efficiency, abolishment of the National Reconstruction Levy on corporate bodies. The data and forecasts presented are, unless otherwise indicated, those of the GoG and may or may not reflect views of outside analysts or Post. Parliament approved the appropriation for the budget on December 15. The budget states some figures in cedis and some in dollars. For ease of reading, cedi figures have been converted to dollars at a rate of 9200 cedis to the dollar. End Summary

Comment and Analysis

¶2. (SBU) The GoG 2007 budget is reasonable, but reaching the targets outlined could well be undermined by the ongoing energy crisis and public sector wage increases. The energy crisis is likely to negatively affect growth as power outages associated with the load shedding are slated to continue through 2007. In addition, some of the government's plans for addressing the crisis over the medium term, in particular the Bui dam, are questionable. The Bui dam idea has been around for many years and reflects an old design (the design dates from 1928). The dam raises substantial environmental, social and feasibility issues, including questions about its lifespan and ability to deliver the desired power given that it will draw from the same river as the Akosombo Dam, which is currently at record low levels.

¶3. (SBU) While the receipts target is generally achievable, the expenditure target may be over-run if government is not able to convince public sector workers to accept the proposed 20 percent wage increase, which is lower than most are calling for. Government is in the difficult position of trying to shift wage negotiations from a simplistic entitlement focus to one based on productivity. Even with a 20 percent increase, the projected wage/GDP ratio of 9.6 percent is very high and wage increases could result in inflationary pressure. The projected fiscal deficit is 3.2 percent of GDP. However, the expected 2006 year-end deficit of 4.9 percent (above the target for the year and more than double the 2 - 3 percent at the end of 2005), is worrisome and may be indicative of a loosening of fiscal constraint not predicted in the budget.

¶4. (SBU) Government borrowing and Ghana's re-entry into capital markets bear close watching. The government has already borrowed USD 20 million for 50th anniversary of Independence celebrations and another USD 11 million is earmarked in the 2007 budget. The GoG is sensitive to the need to maintain external debt sustainability but with the conclusion of the IMF Poverty Reduction and Growth Facility program, there are no formal constraints currently in place and there is considerable pressure and temptation to borrow for high profile infrastructure projects. The recent passage of the Foreign Exchange Bill by Parliament will allow foreign investors to buy domestic government securities. It is hoped that this will help Government's domestic debt management objectives by extending the yield curve and driving medium term interest rates down against a backdrop of moderating inflation. In its inaugural five year domestic bond on December 21, 2006, Ghana borrowed 756.6 billion cedis (about USD 82 million) at a rate of 14.47%. The majority of these funds are to be used for domestic debt restructuring including retiring older more expensive one year notes.

¶5. (SBU) Ghana's main opposition party, the NDC, has specifically criticized high government borrowing, which they believe is fueling corruption and debt and crowding out private investment. The IMF resrep suggested that the budget was short on "second generation" reforms in areas of finance, privatization and deregulation that would lead to a true institutionalization of a market economy. End comment and analysis.

2006 Economic Performance

Growth

¶6. (U) Real GDP is expected to increase to 6.2 percent, exceeding projections of 6.0 percent. The largest contribution to growth came from crops and livestock, accounting for 1.4 percentage points, up from 0.8 percentage points in 2005. Cocoa contributed 0.4 percentage points. Comment: The data set out in the budget indicate

that water and electricity's contribution to growth more than doubled in 2006 from 0.3 to 0.7 percentage points. However, experts have questioned whether the data are accurate. Demand for

electricity has grown considerably but it is not clear whether supply actually increased or simply shifted around to meet the most urgent needs. End comment.

Inflation

¶7. (U) At end-November 2006, the 12-month consumer price index (CPI) inflation was 11.3 percent, and expected to be 11.2 end-December 2006. This is above the target but below the 14.9 percent of 2005. The cedi remained relatively stable, depreciating by 0.9 percent against the dollar as of the end of September. The benchmark 91-day Treasury bill rate at the end of September fell from 14.0 percent at the end of 2005 to about 10.4 percent. Banks' average lending rate, however, remained high at 27.75 percent, the same level as September 2005. Note: On December 18, the Bank of Ghana recently lowered its prime rate by 2% to 12.5%. The effect on lending rates remains to be seen. End note.

Balance of Payments

¶8. (U) The GoG expects to end 2006 with a balance of payments surplus of USD 178.8 million, compared to the 2005 surplus of USD 84.34 million. Foreign reserves were USD 1,782.7 million, or 3.3 months of imports by the end of September 2006. Note: The Bank of Ghana reported December 18 that Ghana's foreign reserves surpassed the USD 2 billion dollar mark for the first time in October 2006 (3.5 months of imports). End note. Debt service savings, through HIPC and MDRI, is expected to result in USD 500.6 million of debt relief for the year.

¶9. (U) According to projections based on data available as of September 2006, the GoG expects to record a total budget deficit of around USD 608 million, about USD 394 million higher than the deficit recorded in 2005. As a share of GDP, the 2006 deficit is 4.9 percent, above the 4.5 percent target and up from an estimated 2.0 percent at the end of 2005 (according to the most recent version of Ghana's Medium Term Expenditure Framework, 2005-2009). The fiscal gap was financed with domestic borrowing (20 percent), foreign loans (49 percent), and debt relief (31 percent). Net domestic financing of the budget is expected to be about 1.0 percent of GDP, against the net domestic financing target of 0.2 percent of GDP. Total revenue and grants rose to about USD 3.5 billion, an increase of about 15 percent from 2005. Total revenue and grants as a share of GDP fell slightly to 28.4 percent, from 29.1 percent in ¶2005. Out of the total revenue and grants, domestic revenue contributed 78 percent, while grants contributed 22 percent. Total government expenditure also rose in 2006 by about USD 796 million (or 24.5 percent) over its 2005 level. As a share of GDP, total expenditure is 32.4 percent, up from about 31 percent in 2005. About 29.5 percent of total expenditure was spent on wages and salaries and 30.5 percent on capital investment.

Forecast for 2007 Economic Performance

Growth

¶10. (U) The GoG is forecasting 6.5 percent real GDP growth in 2007, again led by agriculture, and a single digit end-of-year CPI inflation of between 7 and 9 percent. GOG hopes to keep international reserves at 3 months of import cover.

Budget Deficit

¶11. (U) The GoG expects to narrow the budget deficit to 3.2 percent of GDP, about USD 478 million. The GoG has scheduled 0.4 percent of GDP net repayment of domestic debt, and will finance the deficit with foreign loans and HIPC debt relief. The budget forecasts about USD 408 million in debt relief for the year.

Revenue and Grants

¶12. (U) Total revenue and grants is expected to increase significantly to about USD 5 billion. As a share of GDP, total revenue and grants is expected to rise about 5 percentage points to nearly 34 percent. VAT, import duties and funds generated from government investments and services are expected to grow strongly to boost domestic revenue. Grants are expected to increase nearly 24 percent to USD 972 million.

Expenditure

¶13. (U) Total expenditure is expected to increase in 2007, up 19.4 percent over its 2006 level. All the increase in expenditure is expected to be spent on salary and wages and transfer payments. The wage and salary bill is expected to rise 20 percent to USD 1.4 billion, a lower increase than the 33 percent increase in 2006.

Transfer payments are expected to rise by USD 574 million to about USD 1.1 billion, mainly due to two accounting factors. First, exemption from import duties for certain manufacturing inputs amounting to USD 369 million is being reported for the first time in the budget as a transfer payment. Second, retention of internally generated funds by public institutions such as universities is expected to generate about USD 243 million, hence the high level of transfer payment.

¶14. (U) Capital expenditure is expected to fall 21.8 percent compared to 2006 to just over USD 1 billion. About 92 percent of the capital expenditure is expected to come from foreign sources (the budget does not specify whether these will be loans or grants).

¶15. (U) The education sector will have the highest expenditure allocation, receiving about 25.5 percent of total expenditure, out of which about 64 percent will be used for wages and salaries. The health sector has the second largest budget allocation, receiving 12.7 percent, out of which 38.6 percent will be used on wages and salaries. On average, about 23 percent of the budgets of government ministries, agencies, and departments is expected to come from donor funds. Note: Some ministries are much more heavily reliant on donor financing than others. For example, the Ministry of Water, Works and Housing depends on donors for 80 percent of its budget. End note.

2007 Tax Changes

¶16. (U) The National Reconstruction Levy, which was reduced in 2006 from a range of 2.5 to 10 percent to a range of 1.5 to 7.5 percent, will cease to exist as of January 1, 2007. The National Reconstruction Levy was introduced in 2001 as a temporary measure to address the government's critical fiscal position at the time. To encourage land title registration, fees on land registration will no longer be based on land value but will be based on flat rates, irrespective of land value. By March 2007, the government will put forward a proposal to rationalize the excise tax regime by moving away from the current ad valorem regime to a specific tax regime. Final withholding taxes on dividends, management and technical services, and rent have been reduced. The following reduced rates will be applicable from 2007: dividends - 8 percent (previously 10 percent); management and technical services - 15 percent (previously 20 percent); and rent - 8 percent (previously 10 percent). The capital gains tax is being reduced from 10 percent to 5 percent. VAT Clearance Certificate (VCCs) will now be required by businesses in activities such as competitive tendering and the clearing of goods at the port. To encourage domestic industry, GoG intends to remove VAT and import duties on raw materials and packaging materials used in manufacturing drugs for treatment of HIV/AIDS, Tuberculosis and Malaria. The GoG also proposed that all locally produced pharmaceutical products be zero-rated for VAT to ensure that locally produced pharmaceuticals compete on the same basis with their imported substitutes.

¶17. (U) To compensate for the loss in tax revenue, the GOG will intensify collection of existing taxes. For example, to encourage compliance of small and informal businesses, the VAT Service will implement a flat rate scheme at 3.0 percent of sales value for firms earning between about USD 21,000 and USD 130,000.

2007 Policy Initiatives & Priority Areas

¶18. (U) IMF: The GoG indicates it plans to maintain its relationship with the IMF through a Policy Support Instrument (PSI). It believes this will provide confidence to the investor community and its Development Partners that the GoG will prudently manage its debt sustainability profile to ensure macro stability while pursuing needed infrastructure investments, including through borrowing from international capital markets.

¶19. (U) ECOWAS: To meet the deadline for reaching agreement on an ECOWAS Common External Tariff by end-2007, Ghana and the ECOWAS countries will need to negotiate acceptable tariff levels for the 600 tariff lines for which individual countries have registered proposed exceptions. Completion of negotiation by the end of the year will require Ghana to make changes in the current tariff levels of some imports to conform to the new levels that will be adopted by the sub-region.

¶20. (U) Public Sector Reform: The GoG will continue its program of public sector wage reform by beginning to rationalize public sector wages and salaries. The public service of Ghana is currently made up of 650,000 employees of which 350,000 are employed by 110 agencies, department and state-owned enterprises. The public sector wage bill is currently equal to about 9.5 percent of GDP (i.e., about 1 billion). To demonstrate the continued commitment to the pay reform agenda, government will establish a Fair Wages Commission

with full time responsibility to administer the new Comprehensive Pay Structure, maintain its integrity and ensure equity on an ongoing basis. Measures will also be put in place to improve the monitoring of payroll expenditures and eliminate the incidence of ghost workers. To enhance productivity, all public institutions will be required to install biometric clock-in systems, a measure being piloted at the Controllers Office.

¶21. (U) Energy: To address the shortage in power supply and reduce the load shedding that started at the end of August 2006, the GoG plans to acquire a 126 MW thermal plant at Tema, relocate the 125 MW Osagyefo Barge (which has never operated) to Tema in order to access the nearly-completed West Africa Gas Pipeline and, in collaboration with other entities, procure an 80 MW power plant to meet emergency needs. The Osagyefo barge and the 126 MW power plant are expected to be operational by August 2007. To address long-term supply, a 300 MW thermal power plant will be installed in Tema by 2009 and financing arrangements for the expansion of the Takoradi International Company power plant by 110 MW is to be completed to enable construction to begin in 2007. The GoG is also in discussions with the Chinese Government regarding funding for the 400MW Bui Dam, currently estimated at US$600.0 million. MDRI resources are also slated to be used to support the Volta River Authority (Ghana's energy supplier).

¶22. (U) Utility Pricing: The GoG will introduce full cost recovery pricing at all levels for consumption of water and electricity.

¶23. (U) ICT: The GoG will begin work to extend Voltacom's Fibre Optic assets of the Volta River Authority into an open access national communication backbone. It will be financed with a USD 30 million concessionary loan from the Government of China through China Exim Bank.

¶24. (U) Privatization: The privatization of Ghana Telecom and Westel will be completed in 2007 to promote competitiveness in the telecommunication sector. The GoG also intends to reduce its interest in GOIL, SIC, and three banks, namely Ghana Commercial Bank, Agricultural Development Bank, and National Investment Bank by selling shares on the Stock Exchange.

¶25. (U) Child labor: The implementation of the Program of Action on the Elimination of Worst Forms of Child Labor in the Cocoa Industry will begin in 2007. The program is aimed at preventing the worst forms of child labor in cocoa production processes in Ghana by
¶2011. A Human Trafficking Board and a fund for awareness creation for the Human Trafficking Law will be established.

¶26. (U) National ID Card: The National Identification Authority (NIA), established in 2006 will in March 2007 begin mass enrolment of Ghanaians (resident or living abroad) and all permanent legal residents. The NIA is required to create a national database, generate unique identifiers for each individual and subsequently issue secure national identity cards.

¶27. (U) New National Passport: The GoG will introduce new national passports with enhanced security features to meet the required international standards.

¶28. (U) MCA: The first phase of the Millennium Challenge Account project is slated to take off in 2007 with USD 74.8 million for project-related funding

¶29. (U) Debt Relief: Ghana estimates it will benefit from about USD 240 million in HIPC debt relief in 2007. Twenty percent will be used for domestic debt payments and the rest will be used on poverty related expenditure. The Multilateral Debt Relief Initiative total of about USD 174 million will be used to support the funding of the proposed short-term solution to the energy crisis. The Volta River Authority will use the MDRI fund to procure gas turbines and a barge.

¶30. (U) Trade: The draft Domestic Content Bill which will encourage companies operating in Ghana to source a greater percentage of their inputs from Ghana is currently being worked on so that it will not contradict WTO regulations.

BROWN